



STATE OF MICHIGAN  
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter, on the Commission's own motion,	)	
to consider the total service long run incremental	)	
costs and to determine the prices of unbundled	)	Case No. U-11280
network elements, interconnection services, resold	)	
services, and basic local exchange services for	)	
<b>AMERITECH MICHIGAN.</b>	)	
_____	)	

At the January 28, 1998 meeting of the Michigan Public Service Commission in Lansing,  
Michigan.

PRESENT: Hon. John G. Strand, Chairman  
Hon. John C. Shea, Commissioner  
Hon. David A. Svanda, Commissioner

**ORDER ON REHEARING**

On July 14, 1997, the Commission issued an order modifying and approving a total service long run incremental cost (TSLRIC) study methodology for Ameritech Michigan and approving rates, terms, and conditions for Ameritech Michigan to provide unbundled network elements, interconnection services, and resale services. On July 24, 1997, Ameritech Michigan submitted tariff sheets to implement the order.

In response to petitions for rehearing filed by Ameritech Michigan, AT&T Communications of Michigan, Inc. (AT&T), and MCI Telecommunications Corporation (MCI), the Commission granted partial rehearing on September 30, 1997. The Commission defined the scope of rehearing by identifying eight issues. Those issues included the four cost inputs to the TSLRIC models: (1)

cost of capital, (2) depreciation lives, (3) fill factors, and (4) shared and common cost allocations. The other four issues are (5) whether the unbundled local switching charges recover the cost of vertical features, precluding the use of separate charges to recover those costs, (6) the terms and conditions for providing common transport as an unbundled network element, (7) the propriety of the resale discount percentages, and (8) unexplained differences between proposed tariffs submitted by Ameritech Michigan with its initial cost studies on January 21, 1997 and those submitted on July 24, 1997. The Commission denied rehearing in all other respects. The order established filing deadlines for the moving parties' proposals on rehearing and three additional rounds of comments.

On October 21, 1997, Ameritech Michigan, MCI, and AT&T filed their proposals on the rehearing issues.

In its proposal, Ameritech Michigan requested relief with respect to six of the eight issues. For issue (1), Ameritech Michigan proposed that the 10.6% cost of capital required in the July 14, 1997 order be replaced by the confidential cost of capital used in the original cost studies that it filed at the beginning of this case (in January 1997). With respect to issue (2), Ameritech Michigan proposed that the asset lives developed under the Federal Communications Commission's (FCC) prescription approach and adopted in the July 14, 1997 order for depreciation purposes be replaced by the accelerated asset lives used in the original Ameritech Michigan cost studies. On issue (4), which relates to shared and common costs, Ameritech Michigan proposed that the percentage markup approved in the Commission's order be replaced with the specific dollar allocations used in its original cost studies.

For issue (5), Ameritech Michigan claimed that the workpapers submitted with its original cost studies demonstrate that the pricing of its unbundled local switching element does not cover the

additional costs associated with the vertical features of a local switch port. Ameritech Michigan approached issue (6) by denying that it has an obligation under federal law to provide common transport as an unbundled network element. With respect to issue (7), Ameritech Michigan proposed adjustments to the computation of the resale discounts that would lower the discount percentages to 19.83% (from 25.96%) if the competing provider does not use Ameritech Michigan's operator services and directory assistance (OS/DA) and 19.71% (from 19.96%) if the provider purchases Ameritech Michigan's OS/DA services.

MCI's initial proposals addressed issues (3), fill factors, and (6), common transport. With respect to issue (3), MCI proposed that the fill factors supported by Ameritech Michigan and adopted by the Commission be replaced by the higher factors that MCI and AT&T had proposed in their comments filed prior to the July 14, 1997 order. For issue (6), MCI proposed that Ameritech Michigan be required to offer common transport at a usage-sensitive rate of \$0.000109 per minute of use. MCI discussed matters relating to unbundled local switching and nonrecurring charges. AT&T also addressed Ameritech Michigan's tariff submissions with respect to those issues.

On the November 10, 1997 deadline for initial comments on the rehearing proposals, Ameritech Michigan, AT&T, MCI, the Michigan Exchange Carriers Association, Inc. (MECA), Attorney General Frank J. Kelley (Attorney General), and the Commission Staff (Staff) filed comments. On November 21, 1997, the same parties, except for MECA, filed response comments. On December 5, 1997, the parties, except for MECA, filed reply comments.

Having reviewed the parties' comments on rehearing, the Commission observes that much of the discussion addresses issues that are outside the scope of rehearing. Some of the other comments, when addressing issues designated for rehearing, did not bring new or different information to the Commission's attention, but instead repeated or expanded arguments made prior

to the July 14, 1997 order or supplemented those arguments with information that could have been advanced during the earlier phases of this case.

The Commission reminds the parties that the current proceeding is on rehearing from the determinations made in the July 14, 1997 order. As noted in the September 30, 1997 order at 1-2, the Commission's rehearing standard does not permit the parties to raise any argument that they choose, but imposes the following limitations:

Rule 403 of the Commission's Rules of Practice and Procedure, 1992 AACS, R 460.17403, provides that a petition for rehearing may be based on claims of error, newly discovered evidence, facts or circumstances arising after the hearing, or unintended consequences resulting from compliance with the order. A petition for rehearing is not merely another opportunity for a party to argue a position or to express disagreement with the Commission's decision. Unless a party can show the decision to be incorrect or improper because of errors, newly discovered evidence, or unintended consequences of the decision, the Commission will not grant a rehearing.

The Commission reaffirms that Rule 403 governs this proceeding. Information and arguments that do not meet this standard are not entitled to consideration.

In the September 30, 1997 order at 7-8, the Commission defined the scope of proceedings on rehearing as follows:

To summarize, the scope of further proceedings on rehearing shall be limited to the four cost inputs to the TSLRIC models . . . , the recovery of the cost of vertical features as part of unbundled local switching, unbundled common transport, resale, and certain tariff matters. *The Commission finds that the parties' petitions for rehearing should be denied in all other respects and should not be relitigated in this case.*

. . . .

Except for the issue of unbundled common transport (for which Ameritech Michigan acknowledges a responsibility to comply with the FCC's order), *the party seeking rehearing on an issue will have the burden of specifically demonstrating why the July 14, 1997 order was in error and how it should be changed.* To meet this burden, it must file a proposal to resolve the issue by the October 20, 1997 deadline. *The proposals as well as the subsequent comments or affidavits should not merely restate a party's position in general terms, but they should supply new information that was not previously in the record.*

(Emphasis added; footnote deleted). Because much of the discussion in the comments submitted during the rehearing phase of this case does not comply with the Rule 403 standard or the September 30, 1997 order, the Commission has determined that it should disregard those comments in resolving this case. Consequently, this order will focus only on the arguments that are within the proper scope of rehearing. Although already stated in the September 30, 1997 order, the Commission reiterates that the findings and conclusions in the July 14, 1997 order will continue to be effective, except as specifically modified in this order.

#### Cost of Capital

Ameritech Michigan has not presented new arguments or different information to support its position that the cost of capital should be higher than the 10.6% rate approved in the July 14, 1997 order. Moreover, the Commission remains persuaded that the July 14, 1997 order reached the appropriate result regarding the cost of capital. Therefore, the Commission will not alter this determination.

In addition, the Commission rejects the Attorney General's attempts to reargue his position that the cost of capital should be reduced to 9.74%. The Attorney General exercised his opportunity to develop this position in his earlier comments, which failed to persuade the Commission in its July 14, 1997 order. To the extent that he asserts that those arguments have been improved with new or different information, the information is neither material nor persuasive. The Attorney General's attempt to lower the cost of capital continues to rely on book values and is not forward-looking as required by a TSLRIC analysis.

#### Depreciation

In support of its depreciation proposal, Ameritech Michigan argues that the longer asset lives

adopted in the July 14, 1997 order are based on historical data and are not sufficiently forward-looking for a TSLRIC analysis. Ameritech Michigan argues that the accelerating pace of technological change in a more competitive environment means that equipment and systems will become obsolete more quickly than in the past. Ameritech Michigan notes that the Staff's earlier comments in this case characterized Ameritech Michigan's proposal as being within the range of reasonableness.

In reply, AT&T argues that Ameritech Michigan has not presented any evidence showing that the rate of obsolescence has in fact increased, but that Ameritech Michigan continues to use equipment that is many years old. AT&T further contends that Ameritech Michigan has failed to address how the demands of new market entrants for unbundled network elements will affect the rate of replacement of the network or to identify any new technologies that will render current technologies obsolete in the near future. According to AT&T, local exchange carriers' average rate of accrual of depreciation reserves has increased faster in recent years than their rate of retirement of depreciable assets. From this trend, AT&T infers that the FCC's prescription rates for depreciation are accurate and err, if anything, on the side of overstating actual depreciation expense.

The Attorney General agrees with AT&T's assessment that Ameritech Michigan has failed to show that forward-looking asset lives would be significantly less than lives based on current experience. According to the Attorney General, Ameritech Michigan's reliance on expected changes in the future is inconsistent with its use of embedded plant and existing technology in its cost study network configuration, which are less efficient and more costly than the new technologies it assumed as the basis for its proposed depreciation lives.

MECA opposes the FCC prescription lives on the ground that they are not forward-looking.

MECA recommends using asset lives of 10 years for switching equipment, 8 years for circuit equipment, 15 years for buried cable, and 17½ years for buried fiber.

On reconsideration of this issue, the Commission is persuaded that the asset lives proposed by Ameritech Michigan are more forward-looking than those that the Commission initially adopted in the July 14, 1997 order. As such, the Commission concludes that they are more reasonable than the FCC prescription lives, which more closely resemble cost-based regulation than TSLRIC principles. The Commission agrees with Ameritech Michigan and the Staff that, in a more competitive environment, the development of new technologies and a greater sensitivity to customers' needs can be expected to stimulate new investment and hasten the obsolescence of existing equipment. The Commission also finds that Ameritech Michigan's proposal is a reasonable means of recognizing this trend and that the July 14, 1997 order failed to give due attention to these competitive considerations. Ameritech Michigan's cost study methodology should be revised to incorporate the asset lives that it proposed for depreciation purposes.

#### Fill Factors

Although MCI and AT&T continue to advocate increased fill factors based on percentages of usable capacity that approach 100% in many instances, the Commission finds that they have not advanced any material new information or compelling rationale to support this position, which the Commission rejected in the July 14, 1997 order. Although MCI argues on rehearing that the target fill factors it excerpted from Ameritech Corporation's internal documents make adequate provision for administrative and spare capacity, MCI has not demonstrated that the internal documents are current or make the cost assumptions appropriate to a TSLRIC analysis.

#### Shared and Common Costs



Ameritech Michigan argues for adoption of the shared and common cost allocations used in its original cost studies. Reiterating that it based the cost assumptions used in those studies on preliminary budget data for 1997, Ameritech Michigan claims that a comparison of the cost assumptions to the actual expenditures for the first part of 1997 and final budget data for the remainder of 1997 shows that the assumptions were understated. Ameritech Michigan adds that, contrary to suggestions in the July 14, 1997 order, a new study of retail shared and common costs performed later in 1997 shows that more of those costs have been allocated to retail services than to unbundled network elements.

Ameritech Michigan also criticizes the Commission's order for adopting a fixed percentage allocator. Ameritech Michigan contends that it is more appropriate to identify a fixed pool (in dollars) of total shared and common costs and then to allocate the pool of costs to the various network elements. Ameritech Michigan's rationale is that shared costs do not exhibit much sensitivity to demand and do not vary at all in proportion to volume-sensitive costs. Ameritech Michigan adds that common costs do not vary at all with the level of output demanded. In any event, Ameritech Michigan says, the percentage allocators adopted by the Commission are too low to recover its shared and common costs.

In addition, Ameritech Michigan states, there is a computational error in the manner that MCI and AT&T applied the fixed allocator. Because shared and common costs enable service to be provided throughout the local exchange service territories of Ameritech's five-state region, the costs must be allocated over Ameritech's operations for the entire region. The denominator of the allocator expresses the cumulative total element long run incremental costs of providing unbundled network elements in all of Ameritech's operating areas (and is known as the "extended TELRIC").

According to Ameritech Michigan, the July 14, 1997 order altered some of the cost inputs used to

compute the extended TELRIC, thereby requiring a corresponding adjustment to the denominator of the allocator, which MCI and AT&T ignored. Applying the adjustment, Ameritech Michigan computes an increase in the allocator of about 9½ percentage points, assuming that the other cost inputs in the July 14, 1997 order remain unchanged. Aff. of Ruth Ann Cartee, filed Oct. 20, 1997, at para. 29 (confidential version).

AT&T and MCI, collectively, (AT&T/MCI) say that Ameritech Michigan's proposal for allocating shared and common costs is excessive. AT&T/MCI argue that although the accuracy and reliability of 1997 Ameritech preliminary budget data are doubtful, the more fundamental flaw is the methodology, which relies upon embedded costs instead of forward-looking cost projections, fails to accommodate expected future growth in demand, fails to consider whether the costs reflect an efficient operation, and allocates a disproportionate share of the costs to regulated services. AT&T/MCI say that only one part of the budget, representing Ameritech Information Industry Services (AIIS), actually increased and the others declined. According to AT&T/MCI, the AIIS budget increase makes an unrealistic assumption, which is that AIIS is a start-up business and does not share in the economies of scale of Ameritech's overall operations.

AT&T/MCI contend that a fixed percentage allocator for shared and common costs is necessary to ensure that the allocations do not become unduly sensitive to changes in the forecast of demand for the units of output to be provided. They suggest that Ameritech Michigan's demand forecasts are arbitrary and unreliable.

According to AT&T/MCI, Ameritech Michigan's proposed adjustment to the extended TELRIC in computing a fixed allocator is inappropriate because it ignores the countervailing effects of the price elasticity of demand. In other words, AT&T/MCI explain, if the extended TELRIC declines, the price of the unbundled network elements would also decline, thereby

stimulating more demand for the elements. AT&T/MCI claim that the additional revenues resulting from the increased demand will offset the revenue shortfall from the price reduction. Although they cannot compute the precise effects of price elasticity, given that Ameritech Michigan did not provide them with studies analyzing the price/demand relationship, AT&T/MCI suggest that it is fair to infer a one-to-one inverse correlation, thereby avoiding any adjustment for changes in the extended TELRIC.

The Attorney General does not object to the shared and common cost allocator adopted in the July 14, 1997 order. However, he does claim that even lower allocations might be appropriate to ensure that a disproportionate share of the costs are not being shifted to elements that are necessary for competition. As an alternative, he suggests that the Commission revise the allocator downward to 10% as a conservative estimate of shared and common costs.

The Staff agrees with AT&T/MCI that Ameritech Michigan's reliance on updated budgets and expenditures for 1997 proves nothing. The Staff further contends that it is inappropriate for Ameritech Michigan to allocate a disproportionate amount of the shared and common costs to retail services. The Staff adds that nothing done in this case should be understood as conferring approval for Ameritech Michigan's recent retail study of shared and common costs, which is currently at issue in Case No. U-11573 (relating to federal universal service support).

The Staff does agree in principle with Ameritech Michigan's view that its extended TELRIC must be adjusted for changes in the cost inputs used in the TSLRIC studies, as approved in the July 14, 1997 order.

In responding to AT&T/MCI's comments regarding the price elasticity of demand, Ameritech Michigan says that there is no accepted technique for estimating elasticity in a new market for which no prior sales data exist. Ameritech Michigan also contends that AT&T/MCI's assumption

that there is a one-to-one relationship between price and demand is arbitrary and lacks any basis in economic theory.

The Commission finds that the affidavits and comments submitted during rehearing do not provide a basis for altering the determinations regarding shared and common costs in the July 14, 1997 order. Although Ameritech Michigan disagrees with the Commission's decision to adopt AT&T/MCI witness Brad Behounek's approach, it does not offer any new or convincing information to persuade the Commission that Mr. Behounek's approach was not the most suitable of those supported on the record. Ameritech Michigan's revised budget data for 1997 simply update the preliminary data it used in its initial presentation. It proves little more than that some of the budgeted items may have been too low and others too high.

However, the Commission does accept Ameritech Michigan's adjustment related to the extended TELRIC, which the Staff also supported. Changes in cost inputs required both by this order and the July 14, 1997 order would necessarily affect the extended TELRIC and should be reflected in the denominator of the shared and common cost allocator. AT&T/MCI's reliance on the price elasticity of demand as a basis for ignoring the adjustment is not persuasive. Their attempt to estimate the relationship between price and demand is speculative.

In a separate order issued today in Case No. U-11573, the Commission requires Ameritech Michigan to file a revised forward-looking economic cost study for use in determining federal universal service support. Unlike the studies approved in Case No. U-11280, the revised cost study that Ameritech Michigan will file will be based on its proposed retail shared and common cost study, which will become directly at issue in the universal support cost study docket. Nothing in this order addressing the rehearing issues in Case No. U-11280 should be interpreted as approving either the proposed retail shared and common cost study or other proposals in the

universal support cost study case.

### Unbundled Local Switching

Ameritech Michigan's comments in support of additional charges for the vertical features of the local switch do not meet the standard for rehearing, but instead they reiterate the same arguments that the Commission previously found unpersuasive. In making these arguments, Ameritech Michigan relies on the same workpapers that the Commission previously rejected as inadequate as well as some excerpted pages of its cost model documentation. This showing does not demonstrate that there are costs associated with the vertical features that are in addition to those incurred to use the basic switching function (and recovered through the charges for unbundled local switching).

### Common Transport

In the July 14, 1997 order, the Commission mandated that Ameritech Michigan provide common transport or unbundled access to the same public switched network that Ameritech Michigan uses to serve its retail customers. In seeking rehearing on this issue, Ameritech Michigan made reference to the FCC's subsequent issuance of the Third Order on Reconsideration and Further Notice of Proposed Rulemaking, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, FCC 97-295 (Aug. 18, 1997). Although Ameritech Michigan viewed the FCC order as unlawful, it conceded that the terms of the order would alter its obligations to provide unbundled transport, if they survived subsequent legal challenges.

After the Commission's order granting rehearing, the United States Court of Appeals for the Eighth Circuit issued an order on October 14, 1997, in which it amended a portion of its opinion in

Iowa Utilities Bd v FCC, 120 F3d 753 (CA 8, 1997), cert gtd \_\_ US\_\_ (1998).<sup>1</sup> As a consequence of the court's amended decision, Ameritech Michigan now contends that it is under no obligation to provide common transport and proposes to remove all references to common transport from its tariffs. Ameritech Michigan reiterates its earlier proposal to offer inter-office transmission facilities on a dedicated basis, either to single providers or to two or more providers on a shared basis.

The Eighth Circuit's decision, as amended, vacated 47 C.F.R. § 51.315(b), which provides: "Except upon request, an incumbent LEC<sup>[2]</sup> shall not separate requested network elements that the incumbent LEC currently combines." In reaching this result, the court reasoned:

Section 251(c)(3)<sup>[3]</sup> requires an incumbent LEC to provide access to the elements of its network only on an unbundled (as opposed to a combined) basis. Stated another way, § 251(c)(3) does not permit a new entrant to purchase the incumbent LEC's assembled platform(s) of combined network elements (or any lesser existing combination of two or more elements) in order to offer competitive telecommunications services. To permit such an acquisition of already combined elements at cost based rates for unbundled access would obliterate the careful distinctions Congress has drawn in subsections 251(c)(3) and (4)<sup>[4]</sup> between access to unbundled network elements on the one hand and the purchase at wholesale rates of an incumbent's telecommunications retail services for resale on the other. Accordingly, the Commission's rule, 47 C.F.R. § 51.315(b) . . . is contrary to § 251(c)(3) because the rule would permit the new entrant access to the incumbent LEC's network elements on a bundled rather than an unbundled basis.

Slip op. at 2.

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<sup>1</sup>The court's initial ruling in Iowa Utilities upheld in part and vacated in part the rules promulgated by the FCC in its First Report and Order, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 F.C.C.R. 13042 (1996).

<sup>2</sup>A LEC is a local exchange carrier.

<sup>3</sup>47 USC 251(c)(3).

<sup>4</sup>47 USC 251(c)(4), which requires incumbent LECs to offer for resale at wholesale rates services that they provide on a retail basis.

Ameritech Michigan interprets the Eighth Circuit's decision as invalidating any obligation to provide common transport. Ameritech Michigan characterizes common transport as the undifferentiated use of its entire network from the end-use customer's switch line port to the called party's end office line port. As such, Ameritech Michigan contends, an obligation to offer common transport would impermissibly compel the incumbent to provide pre-assembled combinations of various elements, including unbundled local switching, inter-office transmission facilities, and unbundled tandem switching. Ameritech Michigan cites the FCC's statements in its Third Order on Reconsideration, paras. 42, 47 & n.127, which acknowledge that common transport cannot be effectively disassociated from local switching and that a competing carrier could not, as a practical matter, purchase common transport without also purchasing local switching from the incumbent.<sup>5</sup>

Ameritech Michigan further contends that even if common transport could be viewed as distinct from local and tandem switching, it would still entail an impermissible combination of network elements. According to Ameritech Michigan, each of the inter-office transmission links connecting two end offices, two tandem switches, or an end office and a tandem switch, is itself a distinct element. Ameritech Michigan reasons that a service providing for the transmission of signals over its entire network of inter-office transmission facilities would impermissibly combine those elements, contrary to the Eighth Circuit's holding.

Ameritech Michigan also argues that the Commission cannot require common transport to be offered pursuant to its authority under the Michigan Telecommunications Act, MCL 484.2101 et seq.; MSA 22.1469(101) et seq., because the Eighth Circuit's ruling preempts state law in this

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<sup>5</sup>The FCC actually refers to "shared transport," but, in doing so, it makes reference to a concept that is synonymous, or virtually so, with common transport.

respect. Ameritech Michigan draws this conclusion from the Eighth Circuit's observation that mandating combinations of elements "would obliterate the careful distinctions Congress has drawn . . . between access to unbundled network elements on the one hand and the purchase at wholesale rates of an incumbent's telecommunications retail services for resale on the other." Order amending Iowa Utilities, slip op. at 2. Ameritech Michigan argues that a state-imposed obligation to provide common transport and other pre-assembled combinations of elements would be subject to preemption because, if otherwise left to stand, it would erect obstacles to the purposes and policies of the federal Telecommunications Act of 1996.

In addition, Ameritech Michigan argues that imposing an obligation to offer common transport would exceed the Commission's authority, as provided in Section 355(1) of the Michigan Telecommunications Act, MCL 484.2355(1); MSA 22.1469(355)(1). According to Ameritech Michigan, Section 355 mandates that unbundling of basic local exchange service proceed no further than its loop and port components and does not address inter-office transmission facilities or tandem switching. Ameritech Michigan contends that AT&T's and MCI's proposals to use common transport for carrying long-distance traffic demonstrate that common transport is not an element of local exchange service.

In response, MCI and AT&T say that the FCC rejected Ameritech Michigan's arguments opposing common transport in the Third Order on Reconsideration. Observing further that the Eighth Circuit denied a motion to stay the Third Order on Reconsideration,<sup>6</sup> MCI and AT&T argue that the FCC order remains in effect and that Ameritech Michigan must comply with the order by providing common transport. MCI and AT&T further note that the Iowa Utilities decision upheld

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<sup>6</sup>Southwestern Bell Telephone Co v FCC, order of the United States Court of Appeals for the Eighth Circuit, decided October 30, 1997 (Docket Nos. 97-3389/3576/3663). Oral arguments on appeal from the Third Order on Reconsideration were heard in January 1998.



the FCC's broad interpretation of network elements as including "all of the facilities and equipment that are used in the overall commercial offering of telecommunications." 120 F3d 808-09. MCI and AT&T contend that the October 14, 1997 amendment to the Iowa Utilities opinion should be understood as addressing only the narrow question of whether an incumbent provider must provide combinations of elements, a ruling that does not alter the court's broad holding that "a requesting carrier is entitled to gain access to all of the unbundled elements that, when combined by the requesting carrier, are sufficient to enable the requesting carrier to provide telecommunications services." 120 F3d 815. AT&T states that the court's amended opinion did not purport to redefine any unbundled network element or even address common transport.

AT&T further contends that Ameritech Michigan's obligation under federal law to provide access to its unbundled network elements, as reaffirmed in Iowa Utilities, means all elements, including common transport. AT&T responds to Ameritech Michigan's claim that unbundled elements are discrete facilities or equipment by stating that no single element is capable of providing a service by itself, but that each is functionally interdependent and can only be used when combined with others. AT&T asserts that federal law confers the right to purchase any single unbundled network element or all of them as a complete package capable of providing local exchange service.

MCI and AT&T contend that nothing in the Eighth Circuit's decision or its underlying basis in federal law precludes state commissions, acting under state law, from ordering incumbents to provide combinations of elements or to refrain from disassembling elements that were previously combined. They say that federal law sets minimum requirements for unbundling, but does not preclude the states from adopting more demanding requirements of their own to prohibit

discrimination and promote competition. They further explain that the Eighth Circuit merely held that the FCC lacked authority under federal law to promulgate a rule, but that the court did not preempt the states from adopting the same standard.

Regarding the issue of preemption, MCI and AT&T cite Section 251(d)(3) of the federal act, which provides:

In prescribing and enforcing regulations to implement the requirements of this section, the [FCC] shall not preclude the enforcement of any regulation, order, or policy of a State commission that—

(A) establishes access and interconnection obligations of local exchange carriers;

(B) is consistent with the requirements of this section; and

(C) does not substantially prevent implementation of the requirements of this section and the purposes of this part [Part II, or 47 USC 251 et seq.].

47 USC 251(d)(3).<sup>7</sup> AT&T further cites the discussion of the court in Iowa Utilities, 120 F3d 806, addressing this statute:

It is entirely possible for a state interconnection or access regulation, order, or policy to vary from a specific FCC regulation and yet be consistent with the overarching terms of section 251 and not substantially prevent the implementation of section 251 or Part II. In this circumstance, subsection 251(d)(3) would prevent the FCC from preempting such a state rule, even though it differed from an FCC regulation.

AT&T concludes that a Commission-imposed common transport obligation would not be susceptible to preemption because it furthers the purpose of the federal act to introduce

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<sup>7</sup>A similar statutory provision also cited by MCI and AT&T is Section 261(c), which provides:

Nothing in [Part II] precludes a State from imposing requirements on a telecommunications carrier for intrastate services that are necessary to further competition in the provision of telephone exchange service or exchange access, as long as the State's requirements are not inconsistent with [Part II] or the [FCC's] regulations to implement [Part II].

47 USC 261(c).

competition into local exchange markets.<sup>8</sup>

MCI argues that relieving Ameritech Michigan of the obligation to provide common transport in combination with other elements would mean that the retail services of competing providers would be inferior to, and more costly than, those provided by incumbents. According to MCI, discrimination of this variety would violate both Section 251(c)(3) of the federal act and Sections 305(1) and 355(1) of the Michigan act, MCL 484.2305(1); MSA 22.1469(305)(1), MCL 484.2355(1); MSA 22.1469(355)(1).

AT&T also relies on Section 355 as creating a duty for Ameritech Michigan to provide common transport. AT&T cites Section 355(2), which provides: “Unbundled services and points of interconnection shall include *at a minimum* the loop and the switch port.” Emphasis supplied in AT&T’s reply comments at 10. AT&T interprets this phrase as conferring authority for the Commission to require further unbundling, including common transport. MCI focuses on the statutory definition of a “port” as “the entirety of local exchange service [except for the loop], including . . . switching software, local calling, and access to . . . interexchange and intra-LATA toll carriers.” MCL 484.2102(x); MSA 22.1469(102)(x). MCI reasons that the statutory definition of a port encompasses common transport as part of a local calling service.

MCI and AT&T also argue that Iowa Utilities does not alter Ameritech Michigan’s preexisting contractual obligations to provide pre-assembled combinations of elements under its interconnection agreements.

MCI and AT&T propose that common transport be offered in conjunction with unbundled local switching for both local and long-distance calling. MCI further proposes (and AT&T

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<sup>8</sup> Ameritech Michigan says that Section 251(d)(3) does not forestall preemption because common transport, in its view, is inconsistent with Section 251.

supports) a common transport rate of \$0.000109 per minute of use, which MCI derived from Ameritech Michigan's TSLRIC studies for Call Plan 50 and Call Plan 400 (residential retail) services. MCI and AT&T also object to Ameritech Michigan's tariff provision requiring competing local exchange carriers to subscribe to dedicated trunk ports and collocation, which they view as an interface with dedicated transport links that would be unnecessary for common transport. Finally, MCI and AT&T say that requiring collocation is unnecessary and inefficient from a technical standpoint and would raise the cost of providing service through unbundled network elements.

The Staff says that the Commission should reaffirm the determinations regarding common transport in its July 14, 1997 order. The Staff's view is that the Eighth Circuit's ruling does not alter the validity of the July 14, 1997 order. The Staff adds that Ameritech Michigan should be ordered to delete tariff provisions that are inconsistent with common transport; e.g., the requirement that a competing provider subscribe to at least one dedicated trunk port.

The Commission rejects Ameritech Michigan's contention that the amended opinion in Iowa Utilities requires a different understanding of the legal considerations applicable to common transport than that in effect when the Commission issued the July 14 and September 30, 1997 orders in this case. Contrary to Ameritech Michigan's interpretation of the law, the Eighth Circuit's amended opinion of October 14, 1997 did not purport to address common transport, overrule the FCC's Third Order on Reconsideration, or redefine how unbundled inter-office transmission facilities should be made available. Common transport, as that term is defined by the FCC and used in this Commission's orders, is a functionality provided through inter-office transmission facilities. Although it may be used in conjunction with other equipment and functionalities to provide a complete telecommunications service, it is not materially different from

the other unbundled components of the network in this respect. No single component is capable of providing local exchange service on a stand-alone basis. Ameritech Michigan's argument that common transport embraces several discrete elements is basically an argument over how to define a network element. The Commission finds that the facilities used to provide common transport have the unifying characteristics of a network function and that it is therefore appropriate to address common transport as an unbundled network element. Moreover, the Commission finds much merit in the FCC's reasoning rejecting Ameritech Michigan's arguments to the contrary in the Third Order on Reconsideration.

The Commission further finds that even if Ameritech Michigan's interpretation of federal law were valid, the Michigan Telecommunications Act requires the Commission to administer and enforce the obligations of incumbent providers to offer common transport. Section 355(2) states that unbundling of basic local exchange service requires the separation into the loop and port elements "at a minimum." However, the same principles that mandate unbundling make it appropriate to consider further disaggregation of basic local exchange service into more constituent elements than simply the loop and the port. Moreover, unbundling into more and smaller components or functions of the network furthers the competitive purposes and policies of the Michigan Telecommunications Act. The Commission also agrees with MCI that the statutory definition of "port" as "the entirety of local exchange" (except for the loop) used to provide local calling is consistent with the unbundling concepts of the Michigan Telecommunications Act and embraces the common transport function. If it did not, local calling would not be a viable means of terminating any call that did not originate in the same end office.

The Commission also rejects the argument that Iowa Utilities preempts state law, even if Ameritech Michigan's interpretation of the court decision were valid. The decision reflected the

court's conclusion of law that the FCC overstepped its statutory authority in requiring incumbents to combine multiple network elements. As argued by AT&T and MCI, this holding does not inhibit a state commission from mandating various elements or combinations of elements under state law. The federal Telecommunications Act of 1996 explicitly preserves states' authority to impose requirements that accelerate competition in the local exchange market beyond what federal law would otherwise mandate. 47 USC 251(d)(3), 261(c).<sup>9</sup>

Consequently, the Commission sees no reason to depart from its previous determination that Ameritech Michigan should make common transport available as an unbundled network element. The Commission therefore reaffirms the provisions of the July 14, 1997 order relating to common transport and directs Ameritech Michigan to comply with the order by filing tariff provisions that fully implement the common transport obligations.

The Commission further finds that, for the most part, it should not consider additional substantive modifications to common transport at this stage in the proceedings. Therefore, the Commission rejects most of the new proposals put forward by MCI and AT&T, including their proposal to revise the usage-sensitive rate downward. However, an exception pertains to Ameritech Michigan's tariff provisions that are based on its original proposal to provide dedicated transport. As argued by the Staff and others, Ameritech Michigan should be required to eliminate

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<sup>9</sup>In arguing that a common transport obligation would impede the purposes and policies of federal law, Ameritech Michigan apparently relies on the Eighth Circuit's perceived need to maintain the distinction "between access to unbundled network elements on the one hand and the purchase at wholesale rates of an incumbent's telecommunications retail services for resale on the other." Order amending Iowa Utilities, slip op. at 2. However, providing common transport as an unbundled network element would not erode that distinction. A competing provider of local exchange service would continue to face a choice between the different risks and benefits of combining common transport with other elements (as well as its own facilities), on the one hand, and purchasing retail local exchange service at the resale discount, on the other.

those tariff provisions mandating elements and services that are not necessary when a competing provider uses common transport. As examples, the tariffs may not obligate the provider taking common transport also to pay for a dedicated trunk port or to subscribe to collocation as a means of terminating its unbundled access to common transport facilities. As already noted, Ameritech Michigan must also revise its tariffs to be consistent in all other respects with the July 14, 1997 order's provisions relating to common transport.

### Resale Discount

The Staff's avoided cost model computes the resale discount percentage by dividing the retail costs that the provider would avoid incurring in a wholesale setting by the provider's total revenues that would be subject to resale. As approved in the July 14, 1997 order, the resale discounts computed under the model were 25.96% if the purchasing provider chooses not to use Ameritech Michigan's OS/DA services and 19.96% if the provider purchases Ameritech Michigan's OS/DA services. Although Ameritech Michigan generally accepts the model, it proposes three revisions on rehearing.

Ameritech Michigan's first proposed revision addresses the treatment of OS/DA-related costs in the computation of the discount applicable to providers purchasing services "without OS/DA." Although Ameritech Michigan agrees that OS/DA revenues should be removed from the denominator (revenues subject to resale), it does not agree that the numerator (avoided costs) should also be increased by the costs of providing OS/DA. Ameritech Michigan says that those costs (which appear in accounts 6220—operator systems expense, 6621—call completion services, and 6622—number services) would not be charged to "without OS/DA" customers, so that making an additional provision for them in the numerator effectively double-counts them.

Second, Ameritech Michigan says that an adjustment reducing the "without OS/DA"

numerator is necessary to ensure that the OS/DA-related retail costs that it would avoid in a “with OS/DA” wholesale setting are not double-counted in a “without OS/DA” wholesale setting. (The cost accounts affected by this adjustment are 6610—marketing and 6623—customer services.) In Ameritech Michigan’s view, providing OS/DA services consumes these costs in the same proportion as any other retail service. To implement this assumption, Ameritech Michigan computed the ratio of OS/DA revenues to total revenues subject to resale as 6.614% and reduced the “without OS/DA” avoided costs in accounts 6610 and 6623 by 6.614%.

Third, Ameritech Michigan contends that recent experience in Wisconsin has shown that it will incur costs for uncollectible accounts in a wholesale environment. Ameritech Michigan represents that bankrupt carriers owe it more than \$1.5 million, although it has not written off any of those amounts. Ameritech Michigan further represents that it incurs losses due to uncollectible accounts when it bills interexchange carriers for access charges. Ameritech Michigan proposes that the avoided cost percentage of uncollectible expense be revised from 100%, as proposed by the Staff, to 86.69%, as Ameritech Michigan proposed at the onset of this case. This adjustment would affect both the “with” and “without OS/DA” computations.

In response, AT&T states that the resale discount percentages approved in the July 14, 1997 order are within the range of discounts approved in other states. AT&T does concede that Ameritech Michigan’s first adjustment (related to accounts 6220, 6621, and 6622) is appropriate. However, AT&T opposes the other adjustments. AT&T argues that there are no avoided costs related to OS/DA in accounts 6610 and 6623, so that an adjustment to remove those costs in the “without OS/DA” scenario is inappropriate. AT&T also argues that Ameritech Michigan’s belief that it will incur some degree of uncollectible expense in its wholesale business is speculative and that indications of bankruptcies or billing disputes affecting Ameritech’s Wisconsin wholesale



customers do not mean that their bills will not be paid.

AT&T also proposes several of its own adjustments. First, AT&T contends that the avoided cost percentage applied to accounts 6220, 6621, and 6622 should be 90%, not the 75% used in the Staff's model. Second, AT&T proposes to increase the numerator of the computation by additional cost accounts, which it says the Staff ignored.<sup>10</sup> The outcome of AT&T's proposals are resale discount percentages of 28.40% without OS/DA and 26.53% with OS/DA.

MCI criticizes Ameritech Michigan's proposed adjustments for being one-sided and piecemeal. MCI says that the Commission should either reaffirm the discount percentages approved in the July 14, 1997 order or adopt MCI's own recalculation that follows through on all of the implications of Ameritech Michigan's position. MCI says its proposed recalculation incorporates the first and third of Ameritech Michigan's adjustments, but it rejects the second adjustment, which would reduce the avoided cost numerator for OS/DA-related costs in accounts 6610 and 6623. MCI claims that every cost category contains some OS/DA-related expenses, but that Ameritech Michigan's limited adjustment is selective and aims to lower the discount.

MCI's recalculation entails several other adjustments. First, it proposes to remove the costs associated with interstate and intrastate toll access and unregulated services from the computation on the ground that those services are not subject to the resale discount. To facilitate this adjustment, it uses Automated Report Management Information System (ARMIS) 43-04 data, which excludes interstate access costs and revenues. Second, MCI continues, its adjustments, as well as the cost effect of Ameritech Michigan's first adjustment, would necessarily affect avoided indirect costs, which are assumed to bear the same relationship to total indirect costs as the ratio of

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<sup>10</sup>These accounts are 6533—operations testing, 6534—operations plant administration, 6560—depreciation - general support, and 7240—operating tax.

avoided direct costs to total direct costs. Because MCI applied the cost effects to reduce the denominator of the ratio, its allocation of avoided indirect costs increased.

MCI's recalculation produces resale discounts of 21.81% without OS/DA and 20.20% with OS/DA.<sup>11</sup>

Ameritech Michigan opposes MCI's and AT&T's counterproposals. In response to MCI's recalculation of the discounts, Ameritech Michigan first argues that it is inappropriate to remove costs of certain services from the denominator of the indirect cost allocator and then apply the allocator to an amount of total indirect costs that reflects those same services. Second, Ameritech Michigan argues that it is not necessary to adjust for unregulated services because the approach adopted by the Commission used ARMIS 43-03 data, which excludes unregulated revenues and costs.

With respect to AT&T's proposal to change the avoided cost percentage for the marketing and customer service accounts from 75% to 90%, Ameritech Michigan says that 75% is conservative, given that 25% of the costs support toll access services that will not change in a resale environment. Ameritech Michigan criticizes AT&T's inclusion of avoided costs associated with other accounts as speculative and unrealistic in a wholesale setting.

The Staff concedes that Ameritech Michigan's first adjustment, relating to the removal of OS/DA-related expenses in accounts 6220, 6621, and 6622, is correct and should be incorporated in computing the "without OS/DA" discount. The Staff says that this change should also increase the indirect cost allocator. However, the Staff opposes Ameritech Michigan's other two adjustments and otherwise supports the determinations in the July 14, 1997 order. The Staff

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<sup>11</sup>MCI's computed resale discount percentages appear in its revised Exhibit DLR-5, which was filed with its reply comments on December 5, 1997 and correct its computations that were filed in an earlier phase of the case.

computes the resale discount without OS/DA to be 21.55% and also recommends that the Commission not change the “with OS/DA” discount of 19.96% that was adopted in the July 14, 1997 order.

Ameritech Michigan’s first adjustment, which reduces the “without OS/DA” numerator by OS/DA-related costs in accounts 6220, 6621, and 6622, corrects a computational irregularity. The Staff and AT&T concede that it is appropriate. Therefore, the Commission accepts this adjustment. However, the other adjustments proposed by Ameritech Michigan, as well as those proposed by AT&T and MCI, are disputes over judgmental matters that the Commission previously rejected in its July 14, 1997 order. The Commission finds that those adjustments rely on speculative assumptions, lack persuasive support in the record, and do not otherwise meet the standard for rehearing. Therefore, the Commission revises the “without OS/DA” discount to 21.55%, as recommended by the Staff, and retains the “with OS/DA” discount of 19.96%, as approved in the July 14, 1997 order.

#### Tariff Changes

Except for the tariff provisions that are inconsistent with the common transport provisions in the July 14, 1997 order or with other provisions of that order and today’s order, the Commission finds that the tariff provisions submitted by Ameritech Michigan on July 24, 1997 are appropriate.

## Conclusion

The modified cost inputs approved in this order are Ameritech Michigan's depreciation proposal and the extended TELRIC adjustment relating to shared and common costs (but not Ameritech Michigan's overall proposal for allocating a pool of shared and common costs). In addition, Ameritech Michigan shall revise those tariff provisions that are inconsistent with the common transport obligations set forth in the July 14, 1997 order. The tariff revisions must make clear that a competing provider subscribing to common transport is under no obligation to use dedicated trunk ports or collocation as the means of using common transport in conjunction with other unbundled network elements to provide local exchange service. Finally, the resale discount for competing providers that choose not to use Ameritech Michigan's OS/DA services will be revised to 21.55%. The Commission finds that rehearing should be denied in all other respects.

Ameritech Michigan shall rerun its cost studies with the cost input modifications approved in this order and shall submit those studies, together with all tariff changes necessary to implement this order, to the Commission within 14 calendar days after this order is issued. The cost studies shall be treated as confidential.

The Commission FINDS that:

a. Jurisdiction is pursuant to 1991 PA 179, as amended by 1995 PA 216, MCL 484.2101 et seq.; MSA 22.1469(101) et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; MSA 3-.560(101) et seq.; and the Commission's Rules of Practice and Procedure, as amended, 1992 AACCS, R 460.17101 et seq.

b. The inputs used in Ameritech Michigan's cost studies should be modified as set forth in this order.

c. Ameritech Michigan's tariffs should be modified to be consistent with the common

transport provisions in the July 14, 1997 order.

d. Ameritech Michigan's resale discount for bundled retail services should be 21.55% if the purchasing provider does not obtain OS/DA services from Ameritech Michigan.

e. In all other respects, the petitions for rehearing should be denied.

THEREFORE, IT IS ORDERED that:

A. The modifications to Ameritech Michigan's cost study methodology and proposed rates, terms, and conditions for unbundled network elements, interconnection services, and resale services are approved, as discussed in this order. In all other respects, the petitions for rehearing are denied, and the cost methodologies and rates, terms, and conditions approved in the July 14, 1997 order shall remain in effect.

B. Ameritech Michigan shall file total service long run incremental cost and related studies and tariffs, with the modifications required by this order, within 14 calendar days.

*The Commission reserves jurisdiction and may issue further orders as necessary.*

*Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, pursuant to MCL 462.26; MSA 22.45.*

MICHIGAN PUBLIC SERVICE COMMISSION

/s/ John G. Strand  
Chairman

( S E A L )

/s/ John C. Shea  
Commissioner

/s/ David A. Svanda  
Commissioner

*By its action of January 28, 1998.*

/s/ Dorothy Wideman  
Its Executive Secretary

rehearing are denied, and the cost methodologies and rates, terms, and conditions approved in the July 14, 1997 order shall remain in effect.

B. Ameritech Michigan shall file total service long run incremental cost and related studies and tariffs, with the modifications required by this order, within 14 calendar days.

The Commission reserves jurisdiction and may issue further orders as necessary.

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, pursuant to MCL 462.26; MSA 22.45.

MICHIGAN PUBLIC SERVICE COMMISSION

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Chairman

\_\_\_\_\_  
Commissioner

\_\_\_\_\_  
Commissioner

By its action of January 28, 1998.

\_\_\_\_\_  
Its Executive Secretary

In the matter, on the Commission's own motion, )  
to consider the total service long run incremental )  
costs and to determine the prices of unbundled )  
network elements, interconnection services, resold )  
services, and basic local exchange services for )  
**AMERITECH MICHIGAN.** )  
\_\_\_\_\_ )

Case No. U-11280

Suggested Minute:

“Adopt and issue order dated January 28, 1998 requiring, on rehearing, modifications to the cost studies, resale discount, and tariff provisions submitted by Ameritech Michigan relating to its unbundled network elements, interconnection services, and resale services, as set forth in the order.”